CECL for Non-financial Institutions

AUGUST 2022

In 2016, the Financial Accounting Standards Board ("FASB") issued new accounting guidance to estimate credit losses on financial assets, with staggered effective dates commencing in January 2020. While banks and other traditional financial institutions will be most affected by the FASB's new credit impairment model for financial assets based on current expected credit loss ("CECL"), all entities with balances due (e.g., trade receivables) or that have an off-balance-sheet credit exposure (e.g., financial guarantees) will be impacted. These include companies in the consumer and retail industry, manufacturing entities and other non-financial institutions.

This publication summarizes key aspects of the CECL standard typically applicable for non-financial institutions in a simplified Q&A format.

1 **What is CECL and how does it differ from the existing impairment model?**

2 **What type of financial assets are within the scope of CECL?**

3 **What type of financial instruments are outside the scope of CECL?**

4 **Are operating lease receivables in the scope of CECL?**

5 **Are trade receivables within the scope of CECL?**

6 **Is an equity investment within the scope of CECL?**

7 **Did the model for AFS Debt Securities change?**

8 **When is CECL effective?**

9 **Is CECL effective retrospectively or prospectively?**

10 **Are new disclosures required under CECL?**

11 **What type of disclosures apply prior to adopting CECL?**

12 **Will adopting CECL impact an entity's internal control over financial reporting?**

1 WHAT IS CECL AND HOW DOES IT DIFFER FROM THE EXISTING IMPAIRMENT MODEL?

CECL refers to the credit impairment model provided in Accounting Standards Update ("ASU") 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, as subsequently amended.

The ASU requires credit losses on most financial assets carried at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the CECL model). Under this model, entities will estimate credit losses over the entire "contractual term" of the instrument (i.e., considering estimated prepayments) from the date of initial recognition of that instrument. The FASB clarified that any extension or renewal options (except those recognized as derivatives) that are not unconditionally cancellable by the entity should be considered in the contractual term.[1] The initial measurement of expected credit losses, as well as any subsequent change in the estimate of expected credit losses, is recorded as a credit loss expense (or reversal) in the current period income statement. The objective of CECL is to provide financial statement users with an estimate of the net amount the entity expects to collect on those assets.

When measuring credit losses under CECL, financial assets that share similar risk characteristics (e.g., risk rating, effective interest rate, type, size, term, geographical location, vintage, etc.) should be evaluated on a collective (pool) basis, while financial assets that do not have similar risk characteristics must be evaluated individually.[2] The ASU provides an indicative list of risk characteristics, which includes both credit and non-credit related characteristics.[3] The ASU indicates that financial assets can be aggregated into pools based on any one or a combination of risk characteristics. However, in practice, it is expected that some credit-related characteristic would be considered. Further, the ASU does not prescribe a specific methodology for measuring the allowance for expected credit losses. For example, an entity may use discounted cash flow methods, loss-rate methods, roll-rate methods, probability-of-default methods, or methods that utilize an aging schedule.

However, the ASU does require that an entity base its estimate on:

- Available and relevant internal and/or external information about past events, e.g., historical loss experience with similar assets,
- Current conditions, and
- Reasonable and supportable forecasts that affect the expected collectability of the reported amount of financial assets.

For periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses, an entity should revert to historical loss information that is reflective of the contractual term of the financial asset. An entity may revert to historical loss information immediately, on a straight-line basis or using another rational and systematic basis, depending on its facts and circumstances. The reversion method is not a policy election; an entity should support the reversion methodology and period it uses to develop its estimates of expected credit losses. The expected credit loss is recorded as an allowance for credit losses, adjusted for management's current estimate as updated at each reporting date.

1 See ASU 2019-04, Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments.

2 See ASC 326-20-30-2

3 See ASC 326-20-55-5

COMPONENTS OF CECL MODEL

Historical Loss Information
Segments or pools are created based on common loan characteristics. A combination of both internal and external information, including macroeconomic variables, are used to establish a relationship between historical losses and other variables.

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Current Conditions
To reflect current asset-specific risk characteristics, adjustments to the historical data will need to be considered. These adjustments are usually done through a combination of both qualitative and quantitative factors.

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Reasonable & Supportable Forecasts
The forecast period to project expected credit losses should be reasonable and supportable. Document the rationale and provide evidence supporting the reliability and accuracy of economic scenarios and forecasts.

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Revision to History
Entities are to revert to historical loss information when unable to make reasonable and supportable forecasts. The reversion method applied must be well documented and is not a policy election.

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Expected Credit Loss
The results should represent the current expected credit loss over the remaining contractual term of the financial asset or group of financial assets.

In contrast, current US GAAP is based on an incurred loss model that delays recognition of credit losses until it is probable the loss has been incurred. CECL removes the threshold of "probable" and requires recognition of credit losses when such losses are "expected." That is, even though a credit loss event may not have occurred yet, lifetime losses would still be recorded on day one (i.e., origination or purchase of the asset) under CECL based on expected future losses. A reserve is generally required even if the risk of loss is remote. Further, current practice for estimating credit losses is generally focused on the past i.e., historical loss experience and current conditions, whereas CECL also requires consideration of reasonable and supportable forecasts and, if necessary, reversion to historical loss information as mentioned earlier. In other words, CECL is based on the entire expected life of the asset. Accordingly, it is anticipated that credit losses will be both recognized earlier and for a different amount under the new CECL model than under the prior incurred loss model.

Key changes from existing guidance to the new CECL model are summarized below:

	EXISTING GUIDANCE	NEW CECL MODEL
When to recognize credit losses	When probable that loss has been incurred, generally subsequent to initial recognition of the asset	When losses are expected, in almost all cases upon initial recognition of the asset
Period to consider	Not an explicit input to incurred loss model	Contractual term
Information to consider	Historical loss and current economic conditions	Historical loss, current economic conditions, reasonable and supportable forecasts about future conditions (with reversion to historical loss information for future periods beyond those that can be reasonably forecast)
Unit of Account	Pooling generally not required, but permitted	Pooling required when assets share similar risk characteristics

If an asset's risk characteristics changes such that it no longer shares similar risk characteristics with other assets in the existing pool and there is no other pool having similar characteristics, that asset should be evaluated individually. For instance, if a customer files for bankruptcy, that asset is unlikely to share similar risk characteristics as collection would now be based on that customer's facts and circumstances.

2 WHAT TYPE OF FINANCIAL ASSETS ARE WITHIN THE SCOPE OF CECL?

The scope of CECL is broad and includes the following:

ITEM	NATURE
Loan Receivables/Notes Receivable	Financial Assets measured at amortized cost
Held-to-maturity debt securities	Financial Assets measured at amortized cost
Trade receivables and contract assets that result from revenue transactions or other income	Financial Assets measured at amortized cost
Receivables that relate to repurchase agreements and securities lending agreements	Financial Assets measured at amortized cost
Loans to officers and employees	Financial Assets measured at amortized cost
Cash equivalents	Financial Assets measured at amortized cost
Receivables arising from time-sharing activities	Financial Assets measured at amortized cost
Receivables resulting from sales-type or direct financing leases	Net investments in leases recognized by a lessor
Loan commitments, standby letters of credit, financial guarantees, and other similar instruments	Off-balance-sheet credit exposures not accounted for as insurance or derivatives
All reinsurance recoverables, regardless of the measurement basis of those recoverables	Reinsurance recoverables

3 WHAT TYPE OF FINANCIAL INSTRUMENTS ARE OUTSIDE THE SCOPE OF CECL?

The CECL model does not apply to financial assets measured at fair value through net income, available-for-sale debt securities, loans made to participants by defined contribution employee benefit plans, policy loan receivables of an insurance entity, or promises to give (pledges receivable) of a not-for-profit entity.

The FASB observed that some related-party loans may be viewed as a capital contribution rather than a loan to be repaid. Accordingly, it was decided to scope out loans and receivables between entities under common control from the CECL model; however, other related party loans are within its scope.

4 ARE OPERATING LEASE RECEIVABLES IN THE SCOPE OF CECL?

Although the CECL model did not specifically address receivables arising from operating leases, they appear to meet the definition of financial assets and thus would be within its scope. However, the FASB clarified that operating lease receivables accounted for by a lessor in accordance with the leasing guidance in Topic 842 are not in the scope of the CECL model. Instead, impairment of receivables from operating leases should be accounted for in accordance with Topic 842, Leases.[4] Further, being an operating lease, the leased asset remains on the lessor's books and is assessed for impairment like any other similar asset under Topic 360, Property, Plant and Equipment.

4 See Accounting Standards Update (ASU) No. 2018-19, Codification Improvements to Topic 326, Financial Instruments – Credit Losses.

5 ARE TRADE RECEIVABLES WITHIN THE SCOPE OF CECL?

Yes, CECL requires measurement of the expected credit loss even if that risk of loss is remote, regardless of the method applied to estimate credit losses. That is, life-of-asset losses must be considered. However, if a pool of assets has never historically incurred losses and current conditions and supportable forecasts show zero risk of nonpayment, then no allowance is required. However, this is an extremely narrow scope exception for measuring credit losses for a financial asset where even if a technical default occurs, the expectation of nonpayment is zero. The example provided in the ASU is of US Treasury Securities, which are explicitly guaranteed by the sovereign US Government, which can print its own currency. Cash equivalents[5] may also meet the scope exception from measuring credit losses. However, most other types of instruments, including AAA-rated corporate bonds and trade receivables, are not expected to meet this scope exception considering that upon a default the loss is likely to be more than zero. However, the Accounting Standards Codification indicates that the provisions of the Codification need not be applied to immaterial items.[6] But, entities would still be required to document the basis for concluding that CECL does not have a material impact.

The following example adapted from ASU 2016-13[7] illustrates application of the new CECL model to trade receivables for a consumer entity that estimates credit losses using an aging schedule:

Background and Existing Model:

Consumer Entity Appliances Inc. has $40 million of trade receivables. Under prior GAAP, the allowance of $4.8 million is based on aging at period end using historical loss rates as follows (see table on the next page):

- 0% for the current receivables of $19 million.
- 6% for receivables that are 1-30 days past due of $11 million.
- 28% for receivables that are 31-60 days past due of $6 million.
- 54% for receivables that are 61-90 days past due of $3 million.
- 87% for receivables that are more than 90 days past due of $1 million.

5 Short-term highly liquid investments that are readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

6 See ASC 105-10-05-6

7 See Example 5 (ASC 326-20-55-37 through 55-40)

Application of New CECL Model:

Management believes that this historical loss information is a reasonable base on which to determine expected credit losses because the composition of the trade receivables at the reporting date is consistent with that used in developing the historical credit-loss percentages. That is, the similar risk characteristics of its customers and its lending practices have not changed significantly over time. However, management has determined that current reasonable and supportable forecasted economic conditions have deteriorated as compared with the economic conditions included in the historical information. Specifically, unemployment has increased as of the current reporting date, and management expects there will be an additional increase in unemployment over the next 15 months. Based on its past experience for similar increases in the unemployment rate, management adjusts the historical loss rates to reflect the differences in current conditions and forecasted changes for an estimated allowance of $5.2 million (see table below).

AGING (PAST DUE)	AMORTIZED COST BASIS (MILLION)	EXISTING LOSS RATE	EXISTING AL-LOWANCE (MILLION)	NEW ADJUSTED LOSS RATE	ALLOWANCE UNDER CECL
Current	$19,000,000	0%	$0	1.50%	$285,000
1-30 days	$11,000,000	6%	$660,000	6.09%	$669,900
31-60 days	$6,000,000	28%	$1,680,000	28.42%	$1,705,200
61-90 days	$3,000,000	54%	$1,620,000	54.81%	$1,644,300
>90 days	$1,000,000	87%	$870,000	88.31%	$883,050
Allowance			$4,830,000		$5,187,450

Further, CECL requires that trade receivables sharing similar risk characteristics be pooled. An entity should determine whether its current segmentation practices for purposes of the aging analysis under the incurred loss model is consistent with the ASU's requirement to pool financial assets with similar risk characteristics. For instance, management of Appliances Inc. determines that it is appropriate to pool customers by geography (US, World), type (Corporate, Others) and Past Due Status (Aging Buckets). Management could group the trade receivables similar to the table below and then apply the appropriate loss rate(s) determined under CECL to each of the pools/buckets to arrive at the allowance for credit losses:

GEOGRAPHY	TYPE	CURRENT	1-30 DAYS PAST DUE	31-60 DAYS PAST DUE	61-90 DAYS PAST DUE	>90 DAYS PAST DUE
US	Corporate	$X	$X	$X	$X	$X
	Others	$X	$X	$X	$X	$X
World	Corporate	$X	$X	$X	$X	$X
	Others	$X	$X	$X	$X	$X

As indicated above, CECL requires that a credit loss be recorded for expected losses even if the receivable is current i.e., not yet past due. While the entity may expect full recovery on an individual customer contract, on a portfolio (pool) level some loss would generally be expected. The FASB discussed that financial assets generally are priced assuming an estimated likelihood of credit losses on similar assets, even though the entity may initially expect to collect all of the contractual cash flows on each individual asset.[8] Similarly, while an entity might not currently expect a loss on an individual asset, it ordinarily would expect some level of losses in a group of assets with similar risk characteristics. That risk of loss would need to be reflected in the allowance, even if the risk is remote. Further, the allowance needs to consider reasonable and supportable forecasts. Entities should consider relevant data, whether internal, external or a combination of information. As previously noted the standard requires reversion to historical loss information for periods than cannot be forecast based on reasonable and supportable information. However, considering the short-term nature of the trade receivables, it is expected that entities will generally have reasonable and supportable forecasts. Other assets, such as contract assets, may have longer durations, depending on the nature of the arrangement.

8 See BC69 of ASU 2016-13

An example in the ASU regarding estimating the CECL reserve for trade receivables indicates that application of CECL to short-term receivables is not expected to differ significantly from current practice.[9] However, it is key that entities consider forward looking information and expectation of losses in developing and documenting the allowance at inception and each reporting period instead of basing the allowance only on incurred losses. Further, entities need to determine if an allowance should be recognized even for current receivables that are not yet past due.

In general, the process for estimating life-of-trade receivables credit losses using an aging schedule can be summarized as follows:

- Pool receivables with similar risk characteristics.[10]
- Consider whether historical loss rates need to be adjusted for asset specific characteristics (e.g., difference in the portfolio mix).[11]
- Adjust historical loss rates for current conditions and reasonable and supportable forecasts. If required (e.g., for longer duration receivables), revert to historical loss rates for future periods beyond those that can be reasonably forecast.[12]
- Apply revised loss rates to the amortized cost (i.e., trade receivable balance) to determine the CECL allowance.[13]

To ease application of the CECL model, the FASB staff issued a series of Q&As, available on the **designated Credit Losses page on FASB website**, addressing questions related to using historical loss information, making reasonable and supportable forecasts and reversion to historical loss information. A summary is provided below, see the **FASB Q&A Publication** for details[14]:

General Questions about the CECL standard

Q1: Does the application of the word forecast infer computer-based modeling analysis is required? No.

Q2: If an entity's actual credit losses differ from its estimate of expected credit losses, is it required to modify its forecasting methodology? Estimates of expected credit losses often will not predict with precision actual future events. An entity should continue to refine future estimates of expected credit losses based on actual experience.

Historical Loss Information

Q3: Can an entity's process for determining expected credit losses consider only historical information? No.

Q4: How should an entity determine which historical loss information to use when estimating expected credit losses? An entity may use historical loss information that is nonsequential. The appropriate historical loss period can vary between loan portfolios, products, pools, and inputs. An entity should consider both the appropriate historical period and the appropriate length of the period when developing those estimates. An entity should use judgment in determining which historical loss information is most appropriate for estimating expected credit losses, it does not have to use historical losses from the most recent periods. Once the historical period has been chosen, consider adjustments to historical loss information for differences in current asset specific risk characteristics, such as underwriting standards, portfolio mix, or asset term within a pool at the reporting date or when an entity's historical loss information does not reflect the contractual term of the financial asset or group of financial assets. For periods beyond the reasonable and supportable forecast period, an entity should revert to historical loss information that may not be from the same period used to estimate its reasonable and supportable forecast. In other words, an entity should use historical loss information that is more reflective of the remaining contractual term of the financial assets for periods beyond the reasonable and supportable forecast period.

9 See Example 5 (ASC 326-20-55-37 through 55-40)

10 See ASC 326-20-30-2

11 See ASC 326-20-30-8

12 See ASC 326-20-30-9

13 See Example 5 (ASC 326-20-55-37 through 55-40)

14 Staff Q&A Topic 326, No. 2: Developing an Estimate of Expected Credit Losses on Financial Assets

Reasonable and Supportable

Q5: Is an entity required to consider all sources of available information when estimating expected credit losses? No, an entity should consider relevant information that is reasonably available that can be obtained without undue cost and effort. However, an entity should not ignore available information that is relevant to the estimated collectibility of the reported amount.

Q6: What if external data are not costly, but internal data are more relevant to an entity's loss calculation, Is the entity required to obtain and/or use the external data? No, the guidance allows an entity to use judgment in estimating expected credit losses, which includes the flexibility to decide which information should be used in estimating expected credit losses (internal or external data or a combination of both).

Q7: Should an entity use external data to develop estimates of credit losses if internal information is available? The guidance does not prescribe what type of information can be used in developing an estimate of expected credit losses as long as that information is relevant to the entity, which means that an entity can use internal information, external information, or a combination of both internal and external forms of information in developing an estimate of expected credit losses. However, if an entity does not have the internal information that would be relevant to developing expected credit losses, it should consider external information to develop an estimate of expected credit losses.

Q8: May the length of reasonable and supportable forecast periods vary between different portfolios, products, pools, and inputs? Yes.

Q9: Does an entity need to include the full contractual period in its estimate of the reasonable and supportable forecast period? No.

Q10: Should an entity reevaluate its reasonable and supportable forecast period each reporting period? Yes.

Q11: Is an entity required to correlate reasonable and supportable forecasts to macroeconomic data, such as nationwide or statewide data? No.

Q12: When developing a reasonable and supportable forecast to estimate expected credit losses, is probability weighting of multiple economic scenarios required? No.

Q13: Is there a standard threshold that can be used to adjust historical loss information? No.

Reversion to Historical Loss Information

Q14: What should an entity do if it cannot forecast estimated credit losses over the entire contractual term? For periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses, it is required to revert to historical loss information that reflects expected credit losses during the remainder of the contractual term.

Q15: Can an entity adjust the historical loss information used in the reversion period for existing economic conditions or expectations of future economic conditions when developing estimates of expected credit losses? No, However, the historical loss information should be adjusted for differences in current asset-specific risk characteristics.

6 IS AN EQUITY SECURITY WITHIN THE SCOPE OF CECL?

No, CECL is not applicable to equity securities. ASC 321, Investments – Equity Securities provides the applicable guidance for equity securities, including impairment considerations for securities without readily determinable fair values for which the measurement alternative has been elected. Under that ASC, securities without readily determinable fair values for which the measurement alternative has been elected are considered impaired and written down to its fair value if a qualitative assessment indicates that the fair value is less than the carrying value.[15]

Note that preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor is a debt security for accounting purposes, regardless of its legal form.[16] Thus, the CECL model would apply if such preferred stock is carried at amortized cost by the investor, and irrespective of how it is classified by the issuer. In practice, to be considered redeemable at the option of the investor, that investor must have a unilateral right to redeem.

7 DID THE MODEL FOR AFS DEBT SECURITIES CHANGE?

While not in the scope of the primary CECL model applicable to assets carried at amortized cost (and certain other items), targeted amendments were made to the existing impairment model for AFS debt securities. The existing guidance that requires an estimate of credit losses only when the security is considered impaired (i.e., fair value is less than its amortized cost basis) did not change, nor has the requirement to recognize in income the credit losses and in other comprehensive income any noncredit losses. Further, if there is an intent by the entity to sell the impaired security or more likely than not will be required to sell the security prior to recovery of its amortized cost basis, the security's basis should be written down to its fair value through net income in accordance with existing guidance.

However, for an impaired AFS debt security for which there is neither an intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a reduction of the amortized cost basis. As a result, entities will be able to record reversals of credit losses in current period income as they occur, which is prohibited under existing GAAP. Additionally, the allowance is limited by the amount that the fair value is less than the amortized cost basis, considering that an entity can sell its investment at fair value to avoid realization of credit losses.

An entity should not consider the length of time that the security has been in an unrealized loss position to avoid recording a credit loss. Further, in determining whether a credit loss exists, the historical and implied volatility and recoveries or additional declines in the fair value after the balance sheet date should no longer be considered. As a result, whether the impairment is other-than-temporary (OTTI) is no longer a consideration in recording credit losses. Further, unlike the CECL model that required pooling of assets with similar risk characteristics, credit losses for AFS debt securities must be determined on an individual basis and use a discounted cash flow model.

15 See ASC 321-10-35-2 through 35-4

16 See ASC 320-10-20 Definition of Debt Security

8 WHEN IS CECL EFFECTIVE?

The ASU, as amended, has the following effective dates for calendar year end entities:

SEC FILERS EXCLUDING SMALLER REPORTING COMPANIES (SRCS)	January 2020
ALL OTHER ENTITIES (INCLUDING SRCS)	January 2023

All entities may elect to early adopt CECL.

An entity will determine its effective date based on its most recent SRC determination as of November 15, 2019 , in accordance with SEC regulations. The effective date for that entity will not change even if the entity subsequently loses its SRC status.

9 IS CECL EFFECTIVE RETROSPECTIVELY OR PROSPECTIVELY?

It is generally effective on a modified retrospective basis. An entity must apply the amendments through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach), except for certain debt securities and purchased credit impaired assets for which a prospective transition approach is required.

10 ARE NEW DISCLOSURES REQUIRED UNDER CECL?

The objective of the disclosures is to enable a user of the financial statements to understand the credit risk inherent in a portfolio and how management monitors the credit quality of the portfolio, management's estimate of expected credit losses and changes in the estimate of expected credit losses that have taken place during the period.

To achieve the objective, the ASU has numerous required disclosures. Many of the disclosures carry forward from existing requirements. However, CECL made certain amendments (additions and deletions) both to the scope and content of the existing disclosures, as well as introducing new disclosures. For example, unlike existing GAAP, the impairment model for HTM debt securities will differ from that of AFS debt securities. Therefore, many existing disclosures remain for AFS debt securities but are not applicable to HTM debt securities. The ASU requires disclosure of a roll-forward of the reserve account and introduces[17] a requirement that a public business entity present the amortized cost basis within each credit quality indicator by year of origination and gross write-offs recorded in the current period for financing receivables and net investments in leases (vintage).[18] However, except for credit card receivables, there is an exception from having to provide vintage disclosures for receivables, including trade receivables, that are due in one year or less.[19] Systems and processes may need to be updated to not only to be in accordance with the new CECL measurement model, but also for providing the required disclosures including the vintage disclosures.

17 See ASC 326-20-50-6

18 See ASC 326-20-55-15 for Application of the Term Credit Quality Indicator

19 See ASC 326-20-50-9

11 WHAT TYPE OF DISCLOSURES APPLY PRIOR TO ADOPTING CECL?

FASB Accounting Standards Codification (ASC) 250, Accounting Changes and Error Corrections, paragraph 10-S99-5 and Staff Accounting Bulletin (SAB) No. 74 (Topic 11M), Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period, indicate that "registrants should discuss the potential effects of adoption of recently issued accounting standards… [and] that this disclosure guidance applies to all accounting standards which have been issued but not yet adopted by the registrant unless the impact on its financial position and results of operations is not expected to be material."

While SAB 74 disclosures are both qualitative and quantitative, they should become more robust and quantitative as the effective date for a new accounting standard draws near. The following types of SAB 74 disclosures are expected in the periods before new accounting standards are effective:

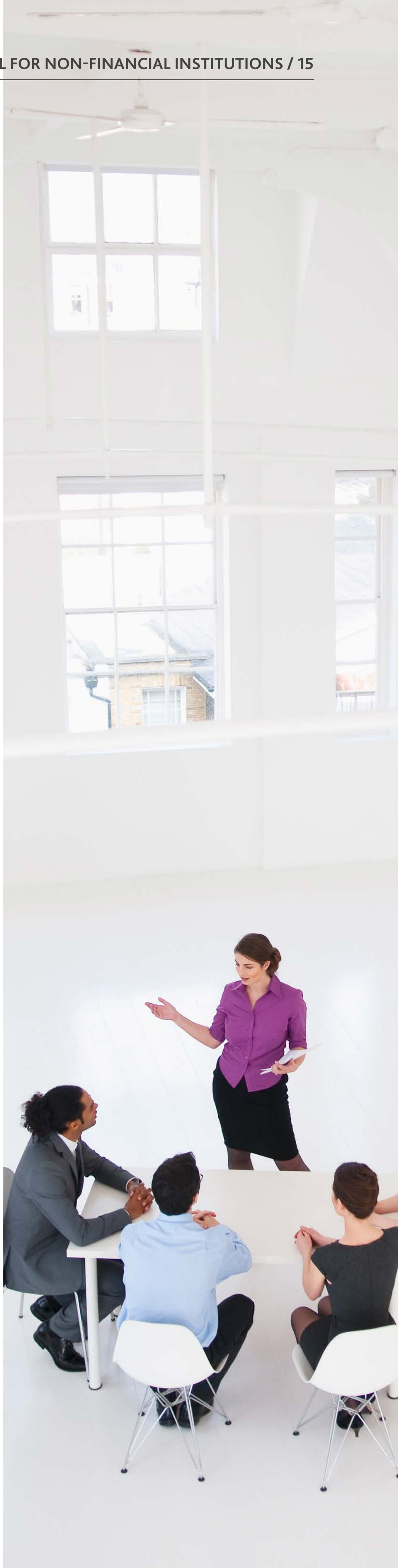
- **A comparison of accounting policies.** Registrants should compare their current accounting policies to the expected accounting policies under the new accounting standard(s).
- **Status of implementation.** The status of the process should be disclosed, including significant implementation matters not yet addressed or if the process is lagging.
- **Consideration of the effect of new footnote disclosure requirements in addition to the effect on the balance sheet and income statement.** A new accounting standard may not be expected to materially affect the primary financial statements; however, it may require new significant disclosures that require significant judgments.
- **Disclosure of the quantitative impact of the new accounting standard if it can be reasonably estimated.**
- **Disclosure that the expected financial statement impact of the new accounting standard cannot be reasonably estimated.**
- **Qualitative disclosures.** When the expected financial statement impact is not yet known by the entity, a qualitative description of the effect of the new accounting standard on the entity's accounting policies should be disclosed.

12 WILL ADOPTING CECL IMPACT AN ENTITY'S INTERNAL CONTROL OVER FINANCIAL REPORTING?

Yes. Those responsible for overseeing the adoption should have proactive and routine conversations with members of senior management and the board of directors to ensure there is sufficient transparency of the adoption efforts and potential impact. Regardless of whether the entity is subject to the provisions of Sarbanes-Oxley, the new standard will impact the internal control environment. Taking a fresh look at the internal control environment is key and should be done early in the adoption process and throughout the various implementation phases.

For example, accumulation of data will be a key element in the credit loss process. Determining the relevance and reliability of the data being used in the forecasting process will be a key challenge for entities. Additionally, developing a forecast that is both reasonable and supportable may consider both publicly available information and involve subject matter experts which may be from internal or external third-party resources. The information used, and judgments made, by decision makers are to be supported by effective internal control structures. Internal controls will vary depending on how the information is derived. For third-party provided data, management may consider control activities to validate integrity, relevance and reliability. Understanding the source of the data and how the data will be used in developing the forecast will be critical to avoid placing inadvertent reliance.

We encourage those charged with oversight of CECL implementation to read the publication issued by the Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) publication on **Internal Control over Financial Reporting for the Current Expected Credit Loss** (CECL) Standard released in November 2018 as well as the Center for Audit Quality's (CAQ) publication related to (**Preparing for the New Credit Losses Standard**), which was published in May 2019 as a tool to be used by Audit Committees.



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